No. 74-799

Supreme Court, U. S.
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# In the Supreme Court of the United States

OCTOBER TERM, 1974

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UNITED STATES OF AMERICA, PETITIONER

*v.*

FOSTER LUMBER COMPANY, INC.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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# In the Supreme Court of the United States

OCTOBER TERM, 1974

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No.

UNITED STATES OF AMERICA, PETITIONER

*v.*

FOSTER LUMBER COMPANY, INC.

---

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT**

---

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in the above-captioned case.

## OPINIONS BELOW

The memorandum and order of the district court, and the stipulation of facts to which it refers (Appendix A, *infra*, pp. 1a-7a), are not reported. The opinion of the court of appeals (Appendix B, *infra*, pp. 8a-14a) is reported at 500 F.2d 1230.

## JURISDICTION

The judgment of the court of appeals was entered on July 29, 1974 (Appendix C, *infra*, pp. 15a-16a). On October 17, 1974, Mr. Justice Blackmun extended the time for filing a petition for a writ of certiorari to and including December 26, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

## QUESTION PRESENTED

Section 172 of the Internal Revenue Code of 1954 permits the carryback of a net operating loss to a taxable year prior to the year in which the loss is sustained, and a carryover to a succeeding year of the amount, if any, by which the loss exceeds the taxable income for each prior year to which the loss may be carried.

The question presented is whether, in carrying back a net operating loss to a year in which the taxpayer had both ordinary income and capital gains and employed the alternative tax computation method of Section 1201, the loss deduction available for carryover to a succeeding year is the amount by which the loss exceeds only the ordinary income for the prior year, as the decision below held, or the amount by which the loss exceeds both the ordinary income and capital gains for the prior year.



## STATEMENT

Respondent is in the lumber business (Appendix A, *infra*, p. 4a).[1] For its taxable years ended March 31, 1966 through 1968, respondent reported the following amounts of ordinary and capital gains income (Appendix A, *infra*, p. 4a):

| Taxable Year | Net Ordinary Income | Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss | Total Taxable Income |
|---|---|---|---|
| 1966 | $ 7,236.05 | $166,634.81 | $173,870.86 |
| 1967 | $114,261.82 | $114,655.96 | $228,917.78 |
| 1968 | ($ 42,203.12) | ——— | ($ 42,203.12) |

Because respondent sustained a net operating loss of $42,203.12 for its taxable year 1968, it elected to carryback that loss to 1966, and filed Form 1139 (Corporation Application for Tentative Refund from Carryback of Net Operating Loss). As the Code prescribes, respondent recomputed its 1966 tax liability under the method provided by Section 11 (the so-called "regular method"), and the "alternative tax computation" provided by Section 1201 of the Code. Taking into account the carryback of the 1968 loss of $42,203.12, respondent's computations of its 1966 income tax liability under each of the two methods were as follows (Appendix A, *infra*, pp. 4a-5a):

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[1] The case was submitted to the district court on a stipulation of facts (Appendix A, *infra*, pp. 3a-7a).

"Regular Method" (Section 11)

| | | |
|---|---|---|
| Taxable Income (excluding net operating loss deduction): | | |
| Ordinary income | $ 7,236.05 | |
| Capital gains income | 166,634.81 | $173,870.86 |
| LESS: Net operating loss deduction resulting from carryback of 1968 net operating loss | | 42,203.12 |
| Taxable Income (Section 63(a)) | | $131,667.74 |
| Regular tax (1966 rates) | | $ 58,200.52 |

"Alternative Method" (Section 1201)

| | | |
|---|---|---|
| Taxable Income (excluding net operating loss deduction): | | |
| Ordinary income | $ 7,236.05 | |
| Capital gains income | 166,634.81 | $173,870.86 |
| LESS: Net operating loss deduction resulting from carryback of 1968 net operating loss | | 42,203.12 |
| Taxable Income (Section 63(a)) | | 131,667.74 |
| (Step 1—Partial Tax) | | |
| LESS: Excess of net long-term capital gain over net short-term capital loss | | 166,634.81 |
| Balance | | ($34,967.07) |
| Partial Tax at Section 11 rates on balance (Section 1201(a)(1)) | | —0— |
| (Step 2—Capital Gains Tax) | | |
| PLUS: Capital Gains Tax at flat 25 percent rate on excess of net long-term capital gain over net short-term capital loss (Section 1201(a)(2)) | | 41,658.70 |
| Alternative Tax (1966 rates) | | $ 41,658.70 |



Since the $41,658.70 tax computed under the "alternative method" of Section 1201 was lower than the tax computed under the "regular method" of Section 11, respondent was required to, and did, report the amount of alternative tax computed under the provisions of Section 1201 as its recomputed 1966 tax liability (Appendix B, *infra*, p. 5a).

This suit involves respondent's tax liability for its taxable year ended March 31, 1967. In applying for a tentative refund from the carryback of a net operating loss for that year, respondent claimed that $34,967.07 of its 1968 loss of $42,203.12, which had been carried back to 1966, was available to offset income for 1967. Respondent based its claim on the contention that its 1968 loss had been "used" in 1966 only to the extent of the ordinary income of $7,236.05 for that year (Appendix A, *infra*, p. 6a).

On audit, the Commissioner of Internal Revenue disallowed respondent's claim for refund for its taxable year 1967 (Appendix A, *infra*, p. 7a). The Commissioner's disallowance was premised on the ground that respondent's 1968 net operating loss of $42,203.12 had been entirely "used" to offset its 1966 taxable income of $173,870.86 for that year. As a result, the Commissioner determined that no part of the 1968 net operating loss deduction was available to respondent to carry forward from its taxable year 1966 to 1967.

The district court upheld respondent's claim for refund (Appendix A, *infra*, pp. 1a-3a) and the court of appeals affirmed (Appendix B, *infra*, pp. 8a-14a).

## REASONS FOR GRANTING THE WRIT

1. The decision below directly conflicts with *Mutual Assurance Society of Virginia Corp.* v. *Commissioner*, C.A. 4, No. 74-1133, decided October 18, 1974. In that case, the Fourth Circuit recognized the conflict and explicitly rejected the reasoning of the court below. It held, on parallel facts, that a corporation which carries back a net operating loss to a year in which it employs the alternative tax computation of Section 1201, may carry forward to succeeding years only the excess of such loss over the prior year's ordinary income *and* capital gains. In concluding that the amount of the loss carryback available to offset income of succeeding years is the excess of the loss over only the prior year's ordinary income, the court of appeals misconstrued the plain terms of Section 172(b)(2) of the Code.

The issue has been and continues to be widely litigated [2] and resolution of the conflict by this Court

[2] The First and Ninth Circuits are in accord with the decision below. See *Chartier Real Estate Co.* v. *Commissioner*, 52 T.C. 346, 356-358, affirmed *per curiam*, 428 F.2d 474 (C.A. 1), and *Olympic Foundry Co.* v. *United States*, 493 F.2d 1247 (C.A. 9), affirming *per curiam* an unreported order of February 9, 1972 (W.D. Wash.). The Tax Court's opinion in *Chartier Real Estate Co.* was the first decision on the question and contains the most detailed statement in support of the court below. In *Axelrod* v. *Commissioner*, No. 74-1511, decided December 17, 1974, reversing 32 T.C.M. 885 (decided August 28, 1973), which involved an individual taxpayer, the Sixth Circuit expressed agreement with the *Mutual Assurance Society* decision of the Fourth Circuit.

These decisions have been followed in *Naegele* v. *United States* (decided August 6, 1973) (D. Minn.), now pending before the Eighth Circuit, No. 73-1921, both of which have been appealed by the government; *Continental Equities, Inc.* v. *Commissioner*, 33 T.C.M. 812 (decided July 25, 1974), and *Data Products Corp.* v. *United States* (decided September 25, 1974) (C.D. Cal.).



is essential in order that there be a uniform national rule.

2. Section 172(b)(1) of the Code, Appendix D, *infra*, pp. 17a-18a, permits a taxpayer to carry back a net operating loss deduction to each of the three taxable years preceding the taxable year in which the loss was sustained. Under the procedure prescribed by Section 172(b)(2), Appendix D, *infra*, p. 18a, the loss is first carried back to the earliest of the three taxable years prior to the year of the loss. For present purposes, to the extent the loss is not fully "used" in the earliest of the prior years, Section 172(b)(2) provides for a carryover of the loss to each of the next succeeding two years. The language of Section 172(b)(2), which is central to the question presented in this case, states as follows:

> The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. * * *

Thus, the amount of the net operating loss which may be carried over to succeeding years is the excess of the amount of the loss over the taxpayer's "taxable income" for the earliest year to which the loss is carried back.

As the Fourth Circuit pointed out in *Mutual Assurance Society*, the holding of the court below that respondent's 1968 loss carryback was "used" only to the extent of its 1966 ordinary income, misconstrued the statutory term "taxable income" as it is employed in Section 172(b)(2). That term is defined by Section 63(a) of the Code, Appendix D, *infra*, p. 17a, as gross income less allowable deductions. Under this definition, which is applicable to Section 172(b)(2),[3] "taxable income" would include "all income from whatever source derived" (see Section 61(a)), and would include both ordinary income and capital gains.

Since respondent's 1968 loss of $42,203.12 was less than its 1966 taxable income of $173,870.86, there was no "excess" of the loss over taxable income to be carried over to 1967. The court of appeals' restriction of "taxable income" to include only ordinary income flatly contradicts the definition of that term in Section 63(a).[4]

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[3] The specific language of Section 63(a) applies its definition of "taxable income" to all sections of the Internal Revenue Code contained in Subtitle A, which includes the provisions from Sections 1 to and including 1564.

[4] That the Section 63(a) definition is applicable to Section 172(b)(2) is further demonstrated by the use of the term "taxable income" in many other Code provisions. See *e.g.*, Sections 3, 4, 56, 161, 170 and 211. Indeed, when the term "taxable income" is intended to depart from the Section 63(a) definition, the particular provision includes an explicit



The fact that respondent employed the alternative tax computation under Section 1201(a) does not call for a different result. Section 11 of the Code imposes a "regular" tax on the taxable income of a corporation consisting of the sum of a normal tax equal to 22 percent of the taxable income and a surtax equal to 26 percent of the taxable income exceeding $25,000. However, where part of a corporation's taxable income consists of capital gains, Section 1201(a) prescribes an "alternative" tax computation which must be used when it results in a lower tax than the tax computed under Section 11. The "alternative" computation of Section 1201(a) provides that a corporation shall determine its tax liability by computing the sum of (1) a "partial" tax imposed on its taxable income, at regular Section 11 rates, less capital gains (effectively leaving only its ordinary income subject to the "partial" tax); and (2) a "capital gains" tax imposed at a flat 25 percent rate on the previously excluded capital gains.

As the alternative tax computation employed by respondent for 1966 illustrates (p. 4, *supra*), its

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modification. See *e.g.*, Sections 593(b)(2)(E), 832(a) and 852(b)(2).

The only modifications contained within Section 172 are set forth in Section 172(b)(2)(B) (requiring the exclusion of the net operating loss for the current loss year or any other year thereafter) and Section 172(d) (which applies only to corporations eligible for the special deductions under Sections 242 and 922 and the computations allowed by Sections 243, 244, 245, 246(b), and 247 of the Code). None of these departures from the Section 63(a) definition of "taxable income" is applicable here.

entire 1968 loss was "used" to offset its taxable income for 1966. Indeed, the first mathematical operation of the computation prescribed by Section 1201 (a)—the substraction of the 1968 loss of $42,203.12 from respondent's 1966 income of $173,870.86, which reduced its taxable income for that year to $131,667.74—demonstrates that no part of the loss remained to offset income for 1967.

Contrary to the decision below, the fact that respondent's net capital gains ($166,634.81) exceeded its reduced taxable income ($131,667.74), so that its partial tax under the alternative computation was zero, does not support the conclusion that the 1968 loss was only "used" to the extent of respondent's ordinary income for 1966.[5] That loss had already been "used" to offset respondent's total taxable income (ordinary income plus capital gains) and had been completely absorbed in that process. Thus, the court below has misconceived the import of the alternative tax computation.

This analysis is confirmed by the congressional understanding that no net operating loss carryover is available as a deduction from a year in which the

[5] The Tax Court in *Chartier Real Estate Co.* reached this result by construing the phrase "to which such loss may be carried" in Section 172(b)(2) as modifying the term "taxable income" (see 52 T.C. at 358). However, the Fourth Circuit in *Mutual Assurance Society* specifically rejected this reading of the statute, stating that "[i]f Congress had intended to enact the rule in *Chartier Real Estate*, it certainly chose an obscure verbal formula to convey this meaning" (slip op. at 17).



taxpayer does not suffer an economic loss. See Detailed Discussion of Certain Technical Provisions of the Revenue Bill of 1939 (H. Rep. No. 855, 76th Cong., 1st Sess., p. 17). The figures for 1966 demonstrate that respondent did not suffer an economic loss for that year but in fact had net income of $131,667.74. Thus, there is no remaining loss carryover available to offset income for 1967.

3. We are advised by the Internal Revenue Service that with respect to this issue there are presently pending administratively cases involving 164 corporate taxpayers in which $30,740,027 of revenue is at stake. This figure does not reflect additional amounts which are expected to arise as a result of the attempts by taxpayers to claim net operating loss carryover deductions for succeeding years on the ground that portions of such losses are still available to offset income.[6] Indeed, current economic conditions in which many corporations are incurring losses could substantially increase the administrative importance of the question presented beyond the amount now at issue.

[6] For example, *Data Products Corp.* v. *United States*, *supra*, n. 2, which the district court decided adversely to the government, involves a refund claim of $152,451. However, the taxpayer has claimed an unused loss carryover in excess of $5,000,000.

## CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1974.



## APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MISSOURI
WESTERN DIVISION

No. 19701-1

FOSTER LUMBER COMPANY, INC., PLAINTIFF

*vs.*

UNITED STATES OF AMERICA, DEFENDANT

### MEMORANDUM AND ORDER

This case pends on a full factual stipulation filed April 14, 1972. The facts stipulated in that pretrial order numbered one through fifteen are incorporated by reference and made a part of this opinion. The Pretrial Order also provides that "The parties agree . . . that the issue in this case shall be decided on the basis of the agreed facts contained in this Order and the briefs to be submitted by the parties."

The sole issue, as stated by the plaintiff, is "whether under Section 172(b)(2) of the Internal Revenue Code of 1954 the net operating loss incurred in the fiscal period ending July 19, 1968, having been first carried back to reduce fiscal 1967 taxable income (1) only to the extent such loss exceeds the entire fiscal 1966 taxable income, including the capital gains segment which may not be reduced by such a net operating loss, as the government contends, or (2) to the

extent such loss exceeds that portion of fiscal 1966 taxable income to which such net operating loss may be carried, as the plaintiff contends."

The government candidly states that the only two decided cases on this issue have decided the issue in favor of the taxpayer. *Chartier* v. *Commissioner* (1969), 52 T.C. 346, affirmed (1st Cir., 1970), 423 F. 2d 474, and *Olympic Foundry Co.* v. *United States*, Civil No. 26-71C3 (W.D. Wash., February 9, 1972) appeal docketed No. 72-2128, 9th Cir., June 27, 1972. It submits, however, that the courts in those cases misconstrued Section 172(b)(2) of the Code, and therefore, the decision should not be followed by this Court.

We have carefully reviewed the briefs filed by the parties and the cases cited. We express our agreement with the rationale of *Chartier*, *supra*, and *Olympic Foundry Co.*, and the construction given Section 172(b)(2) by those courts.

We hold, therefore, that the operating loss incurred in fiscal 1968 may be carried to fiscal 1967 taxable income to the extent such loss exceeds that portion of fiscal 1966 taxable income against which the net operating loss may actually be applied in the recomputation of the tax due on fiscal 1966 income.

For the reasons stated it is

ORDERED that this memorandum opinion shall, pursuant to Rule 52 of the Rules of Civil Procedure,



be considered as our findings of fact and conclusions of law. It is further

ORDERED that the defendant shall promptly compute the amount of judgment and submit it to the plaintiff in order that an agreed form of judgment may be entered.

/s/ John W. Oliver
District Judge

Kansas City, Missouri
May 7, 1973

[Caption Omitted]

STIPULATIONS

The parties hereto stipulate and agree that venue is properly laid in this District; that the United States District Court for the Western District of Missouri, Western Division has jurisdiction of the parties hereto and subject matter hereof, and, that all proper, necessary and indispensable parties are before the Court. The following facts are admitted and require no proof:

1. Plaintiff, Foster Lumber Company, Inc., is a Colorado corporation with its principal office located at 912 East Sixty-Third Street, Kansas City, Missouri.

2. Plaintiff is the successor to Foster Lumber Company (a Missouri corporation, Liquidated on July 19, 1968) by virtue of the plaintiff's acquisition of substantially all the operating assets and liabilities of said Foster Lumber Company (hereafter referred to as the taxpayer) under an agreement dated November 22, 1967, in exchange solely for plaintiff's voting stock.

3. Taxpayer kept its books and records and filed its federal income tax returns on the basis of a fiscal year ending March 31.

4. Taxpayer timely filed its U.S. Corporation Income Tax Returns (Forms 1120) for its fiscal years ending March 31, 1966, March 31, 1967 and July 19, 1968, with the District Director of Internal Revenue, St. Louis, Missouri, and paid the amount of tax shown due on the returns.

5. Taxpayer realized taxable income for its fiscal year ending March 31, 1966 of $173,870.86, of which $7,236.05 was ordinary income and the remaining $166,634.81 was net long-term capital gain.

6. Taxpayer realized taxable income for its fiscal year ending March 31, 1967 of $228,917.73, of which $114,261.82 was ordinary income and the remaining $114,655.96 was net long-term capital gain.

7. Taxpayer suffered and reported a net operating loss of $42,203.12 for the fiscal year ending July 19, 1968.

8. Taxpayer filed a Corporation Application For Tentative Refund From Carryback of Net Operating Loss (Form 1139) on September 11, 1968, in which



taxpayer recomputed its tax for its taxable year ending March 31, 1966, taking into consideration the net operating loss carryback from its taxable year ending July 19, 1968.

9. The taxpayer's federal income tax liability for its fiscal year ending March 31, 1966, as computed under the regular method as provided under Section 11 of the Internal Revenue Code of 1954, was $58,-200.52, computed as follows:

| | |
|---|---|
| Ordinary tax: 22% x ($173,870.86—net operating loss carryback of $42,203.12) = | $28,966.91 |
| Surtax: 26% x ($173,879.86—$42,203.12—$25,000 = | 27,733.61 |
| Tax on multiple surtax exemption: 6% x $25,000 = | 1,500.00 |
| Total tax: | $58,200.52 |

10. The taxpayer's federal income tax liability for its fiscal year ending March 31, 1966, as computed under the alternative method as provided under Sections 11 and 1202 of the Internal Revenue Code of 1954, was $41,658.70, computed as follows:

| | |
|---|---|
| Ordinary tax: 22% x ($7,236.05—net operating loss carryback of $7,236.05) = | —0— |
| Capital gains tax: 25% x $166,634.81 = | $41,658.70 |
| Total tax: | $41,658.70 |

(The alternative method, as provided under Sections 11 and 1201 of the Code, was used in computing the taxpayer's tax liability for the fiscal year ended March 31, 1966.)

11. The taxpayer's federal income tax liability for its fiscal year ending March 31, 1967, as determined by the Internal Revenue Service, was $68,-136.45, computed as follows:

| | |
|---|---|
| Ordinary tax: 48% x ($114,261.82—no net operating loss deduction)—$6500 = | $48,345.68 |
| Capital gains tax: 25% x $114,853.96 = | 28,663.99 |
| | $77,009.67 |
| Less: Investment credit | 8,873.22 |
| Total tax: | $68,136.45 |

(The taxpayer paid income tax in the amount of $68,136.45, for the fiscal year ending March 31, 1967. $67,300.74 was paid in accordance with its tax return and $835.91 was paid pursuant to a deficiency assessment.)

12. The taxpayer's federal income tax liability for its fiscal year ending March 31, 1967, as alleged by the plaintiff, was $51,352.28, computed as follows:

| | |
|---|---|
| Ordinary tax: 23% x ($114,261.32—net operating less carryback of $34,967.07) = | $17,444.85 |
| Surtax: 26% x [($114,261.82—34,967.07)—25,000] = | 14,116.64 |
| Capital gains tax: 25% x $114,655.96 = | 28,663.99 |
| | $60,225.48 |
| Less: Investment credit | 8,873.22 |
| Total tax: | 51,352.26 |



13. Taxpayer timely filed its Claim for refund (Form 843) with the Internal Revenue Service for its taxable year ending March 31, 1967 on January 23, 1970, claiming an overpayment of income tax in the amount of $16,784.39, computed as follows:

| | |
|---|---|
| Tax paid | $68,136.65 |
| (minus) Alleged correct tax liability | 51,352.26 |
| Alleged overpayment | $16,784.39 |

14. On or about December 9, 1970, the Internal Revenue Service disallowed taxpayer's Claim for refund.

15. This suit was timely instituted on September 11, 1971.

**APPENDIX B**

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

---

No. 73-1659

---

FOSTER LUMBER COMPANY, INC., APPELLEE

*v.*

UNITED STATES OF AMERICA, APPELLANT

---

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MISSOURI

---

Submitted: January 18, 1974
Filed: July 29, 1974

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Before MEHAFFY, Chief Judge, LAY
and ROSS, Circuit Judges

---

MEHAFFY, Chief Judge.

This is a refund suit by the successor in interest of a Missouri corporation to recover a portion of the



taxpayer's 1967 federal corporate income tax payment. The taxpayer bases its claim on a recomputation of its 1967 tax liability to include the carryback of a net operating loss it had incurred in 1968. The Internal Revenue Service disallowed taxpayer's claim on the ground that the net operating loss in question had been fully absorbed in the recomputation of taxpayer's 1966 tax liability. The district court sustained the taxpayer's refund claim, and IRS brought this appeal. For the reasons stated below we affirm the judgment of the district court.

The relevant facts have been stipulated and may be briefly stated. In fiscal 1966 the taxpayer realized $7,236.00 of ordinary income and $166,634.00 in net long-term capital gains. In fiscal 1967 the taxpayer realized $114,261.00 of ordinary income and $114,656.00 in net long-term capital gains. In fiscal 1968 the taxpayer suffered a net operating loss of $42,203.00. Pursuant to the provisions of INT. REV. CODE § 172 the taxpayer sought to carry back the 1968 net operating loss to its prior taxable years. The taxpayer first carried the net operating loss back to 1966, and there is no dispute over the taxpayer's recomputation of its 1966 tax liability.

Under the regular corporate income tax rates the 1966 liability was recomputed as follows:

| | |
|---|---|
| Taxable Income as Originally Reported | $173,870.00 |
| Net Operating Loss Deduction | 42,203.00 |
| Recomputed Taxable Income | $131,667.00 |
| Regular Corporate Tax on Recomputed Taxable Income | $ 58,200.00 |

Under the alternative tax provided in section 1201 the 1966 tax liability was recomputed as follows:

| | |
|---|---|
| Ordinary Income Element of Taxable Income | $ 7,236.00 |
| Net Operating Loss Deduction | 42,203.00 |
| Recomputed Ordinary Income Element of Taxable Income | —0— |
| Net Long-Term Capital Gain Element of Taxable Income | $166,634.00 |
| Tax on Recomputed Ordinary Income Element | —0— |
| Tax on Net Long-Term Capital Gain Element | 41,658.00 |
| Alternative Tax | $ 41,658.00 |

The alternative tax method resulted in a smaller 1966 tax liability than that computed under the regular rates, and the parties agree that the section 1201 alternative tax is controlling.

Given the agreement among the parties on the recomputed 1966 tax liability, the sole controversy presented here is over the amount of the net operating loss carryback that is available to be carried forward to 1967. The controlling statutory language, in pertinent part, states that:

> The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried.

INT. REV. CODE § 172(b)(2).



The taxpayer contends that the above-quoted language allows it to carry forward to 1967 the excess of the net operating loss over the amount of the 1966 taxable income to which the loss had been carried:

| | |
|---|---|
| Net Operating Loss | $ 42,203.00 |
| Taxable Income to which NOL Was Carried | 7,236.00 |
| NOL to be Carried Forward | $ 34,967.00 |

IRS contends that section 172(b)(2) allows taxpayer to carry forward only the excess of the net operating loss over the total amount of the taxable income for the year 1966:

| | |
|---|---|
| Net Operating Loss | $ 42,203.00 |
| Total Taxable Income | 173,870.00 |
| NOL to be Carried Forward | —0— |

Stated somewhat differently, the issue in this case is whether the last phrase of section 172(b)(2), "to which such loss may be carried," modifies "taxable income" as well as the words "prior taxable years."

The taxpayer concedes that its interpretation of section 172(b)(2) is counter to the position announced in Treasury Regulation 1.172-4(b)(ii), but notes that every court which has considered the issue has squarely rejected the position taken by IRS. *Naegele* v. *United States*, 32 Am. Fed. Tax R.2d 73-5689 (D. Minn. 1973), *appeal docketed*, No. 73-1921, 8th Cir., Dec. 26, 1973; *Olympic Foundry Co.* v. *United States*, 29 Am. Fed. Tax R.2d 72-759 (D. Wash. 1972), *aff'd per curiam*, 493 F.2d 1247 (9th

Cir. 1974); *Sidney Axelrod*, 42 P-H Tax Ct. Mem. ¶ 73,190 (1973), *appeal docketed*, No. 74-1511, 6th Cir., May 7, 1974; *Mutual Assurance Society of Virginia Corporation*, 42 P-H Tax Ct. Mem. ¶ 73,177 (1973), *appeal docketed*, No. 74-1133, 4th Cir., Jan. 28, 1974; *Chartier Real Estate Company*, 52 T.C. 346 (1969), *aff'd per curiam*, 428 F.2d 474 (1st Cir. 1970). IRS concedes that the unanimous weight of judicial opinion is, at least thus far, against its position. IRS argues, however, that these cases are merely ill-considered reaffirmations of an allegedly aberrant secondary holding in the original Tax Court decision on this issue, *Chartier Real Estate Company*, *supra*. Each party also argues that its position is supported by the plain meaning of the statutory language and the policy behind that language.

As one should probably expect in a case involving the Internal Revenue Code, it is impossible to find any plain meaning in the statutory language that would dispose of this controversy. Given the typically tortured wording of the Code, we feel that each of the parties' interpretations presents a plausible reading of section 172(b)(2) on its face. Moreover, the legislative history offers little assistance in ascertaining Congress's intent. Neither party has cited, nor have we been able to find, any legislative history that directly addresses the issue presented in this appeal. We are convinced, however, that the basic policy considerations underlying sections 1201 and 172 decisively support the result reached by the district court.



The basic purpose behind the net operating loss carryback provisions of section 172 is to ameliorate the harsh tax consequences that can result from the necessity of accounting for certain exceptional economic events within the confines of an arbitrary annual accounting period. The purpose behind the alternative tax in section 1201 is to alter the tax rate to reflect the traditionally unique character of income arising out of the sale of capital assets. These purposes are quite distinct, as are the economic events with which they are concerned. IRS contends that the taxpayer's position in this case will result in a double benefit. We agree that the tax benefits of the separate provisions may under certain circumstances be "double," at least in the sense that they are cumulative. But, given the differing purposes behind each benefit, we see no reason why the chance relative timing of basically unrelated economic events should negate the cumulative impact of the separate provisions. Indeed, to hold otherwise would frequently subject otherwise similarly situated taxpayers to significantly different treatment solely on the basis of arbitrary timing; precisely the reverse of section 172's original purpose.

In reaching our conclusion we have carefully examined the Internal Revenue Service's argument regarding the judicial decisions on the issue presently before us. None of the decisions is binding precedent in this court, and several of the opinions are quite brief in their discussion of the issue. Nevertheless, we cannot dismiss lightly the cumulative weight of

our fellow judges' decisions or the divisiveness and administrative confusion that a contrary conclusion at this point might foster.

The judgment of the district court is affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.



## APPENDIX C

## JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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SEPTEMBER TERM, 1973

[Filed Jul. 29, 1974, Robert C. Tucker, Clerk]

No. 73-1659

FOSTER LUMBER COMPANY, INC., APPELLEE

*vs.*

UNITED STATES OF AMERICA, APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MISSOURI

THIS CAUSE came on to be heard on the record from the United States District Court for the Western District of Missouri and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court, that the

judgment of the said District Court, in this cause, be, and the same is hereby, affirmed.

July 29, 1974

Costs taxed
in favor of
Appellee:

| | |
|---|---|
| Costs of printing 25 copies of Appellee's brief: | $49.30 |
| Total cost of Appellee for recovery from Appellant in the U. S. District Court: | $49.30 |

[SEAL]

A true copy:

Attest: /s/ Robert C. Tucker

Clerk, U. S. Court of Appeals, 8th Circuit.



## APPENDIX D

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 63. TAXABLE INCOME DEFINED.

(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

* * * *

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) [as amended by Sec. 317(b), Trade Expansion Act of 1962, P.L. 87-794, 76 Stat. 872] *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to which loss may be carried.*—

(A) (i) [as amended by Sec. 210 (a)(1), Revenue Act of 1964, P.L. 88-272, 78 Stat. 19 and Sec. 3(a)(1), Act of December 27, 1967, P.L. 90-225, 81 Stat. 730] Except as provided in clause

(ii) and subparagraphs (D) and (E), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

(ii) In the case of a taxpayer with respect to a taxable year ending on or after December 31, 1962, for which a certification has been issued under section 317 of the Trade Expansion Act of 1962, a net operating loss for such taxable year shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

* * * *

(2) *Amount of carrybacks and carryovers.*—Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—



(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) [as amended by Sec. 210(b)(1) and (2), Revenue Act of 1964, *supra*] by determining the amount of the net operating loss deduction—

(i) without regard to the net operating loss for the loss year or for any taxable year thereafter, and

(ii) without regard to that portion, if any, of a net operating loss for a taxable year attributable to a foreign expropriation loss, if such portion may not, under paragraph (1)(D), be carried back to such prior taxable year,

and the taxable income so computed shall not be considered to be less than zero. For purposes of this paragraph, if a portion of the net operating loss for the loss year is attributable to a foreign expropriation loss to which paragraph (1)(D) applies, such portion shall be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss.

* * * *

(d) *Modifications.* — The modifications referred to in this section are as follows:

* * * *

(2) *Capital gains and losses of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation—

* * * *

(B) the deduction for long-term capital gain provided by section 1202 shall not be allowed.

* * * *

SEC. 1201. ALTERNATIVE TAX.

(a) [as amended by Sec. 8(g)(3), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960] *Corporations.*—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 821(a) or (c), and 831(a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of such excess, or, in the case of a taxable year beginning before April 1, 1954, an amount equal to 26 percent of such excess.

In the case of a taxable year beginning before April 1, 1954, the amount under paragraph (2) shall be determined without regard to section 21 (relating to effect of change of tax rates).

* * * *



SEC. 1202. DEDUCTION FOR CAPITAL GAINS.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

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